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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM 1946

In the Matter of
PITTSBURGH RAILWAYS COMPANY,
Debtor.

No. 1178

PHILADELPHIA COMPANY,
Petitioner,
v.
JULES GUGGENHEIM, et al.

No. 1179

PHILADELPHIA COMPANY,
Petitioner,
v.
JULES GUGGENHEIM, et al.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

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Counter Statement of Question Involved

In this reorganization under Chapter X of the Bankruptcy Act, where, upon a sworn petition filed by public security holders,—containing undenied allegations charging Philadelphia, as parent of the debtor, with, (1) spoliation and waste of debtor, (2) domination and control of debtor and the resulting detriment to us and all public security holders, (3) possible causes of action or claims available to the estate against Philadelphia, (4) grounds for an equitable limitation or subordination of filed claims, and (5) forfeiture of Philadelphia's rights to assert a claim on a parity with other claims, the District Court directed the Trustee to examine and investigate Philadelphia pursuant to Sections 21 (a) and 167 of the Bankruptcy Act, shall that order for such examination and investigation be extended in scope so as to include an examination and investigation of every public holder of bonds, notes, securities and liabilities to ascertain when and at what price each public security holder acquired his security, in order to bar or limit his claim or to prevent subordination of the claims of Philadelphia, the parent of the debtor, despite the absence of any showing that public holders are subject to Section 212 in Chapter X of the Bankruptcy Act or that the public security holder was a fiduciary of the debtor or constituted any part of the debtor's management?

Statement

After unsuccessfully attempting to escape its (Philadelphia's) examination and investigation pursuant to Sections 21 (a) and 167 of the Bankruptcy Act, directed on our petition, by an order of November 7, 1945 (63 F. Supp. 7 at p. 10), which denied Philadelphia's request that if an investigation be ordered as to it, "a similar investigation should be made with respect to the claims of all creditors", from which no appeal was taken, Philadelphia here seeks a review of denial of its subsequent renewed applications to extend that investigation to us and to "all holders of bonds, notes, securities or liabilities", thousands in number scattered over the United States, and to "all notes, bonds, securities and liabilities" (63 F. Supp. 7; 64 F. Supp. 231; Record pp. 77a-81a). Philadelphia, which operated and managed Pittsburgh Railways System, is the sole stockholder of debtor and most of its underliers constituting that unified Pittsburgh Railways System of transportation (155 Fed. (2) 477, cert. denied). Philadelphia is also the largest creditor according to filed claims. Philadelphia has not been exonerated from the undenied allegations of misconduct charged in our petition.

The Circuit Court of Appeals for the Third Circuit unanimously affirmed two orders made January 21, 1946 and May 1, 1946, in the proceedings for the reorganization of the debtor, by the District Court for the Western District of Pennsylvania, denying Philadelphia's applications to extend the investigation to all creditors.

Opinions Below

The District Court's opinion and order of November 7, 1945 for the examination of Philadelphia under Sections 21 (a) and 167 of the Bankruptcy Act are reported at 63 F. Supp. 7. At that time the District Court rejected the request of Philadelphia that if an investigation be ordered as to it, "a similar investigation should be made with respect to the claims of all creditors". No appeal was taken from order.

The District Court's opinion denying, without prejudice, Philadelphia's November 21, 1945 renewed application to examine all creditors (No. 9125 in the Circuit Court) is reported at 64 F. Supp. 231.

The District Court's opinion denying, with prejudice, Philadelphia's March 6, 1946 further renewed application to examine all creditors (No. 9163 in the Circuit Court) is not yet reported, but appears in the record at pages 77a to 81a.

The unanimous opinion of the Circuit Court affirming Nos. 9125 and 9163 is reported at 159 Fed. (2) 630 and appears in the record at pages 85 to 90.

The Facts

Proceedings Leading to Investigation of Philadelphia

April 23, 1918, the present Trustees, George and C. A. Fagan, were appointed Equity Receivers by the District Court below. These receivers were discharged in February, 1923. Philadelphia participated in bringing this about. Philadelphia postponed "its claims against Pittsburgh Railways Company and underlying street railway companies" (ff. 453-463, 470*).

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* "F" refers to Finding of Fact bearing that numeral in the Report of the Special Master in 155 Fed. (2) 477, cert. denied October 14, 1946, 67 S. Ct. 89.

The Facts.

May 10, 1938, debtor filed a voluntary petition for reorganization under Section 77B of the Bankruptcy Act (f. 1). November 7, 1938, Chapter X made applicable. Three Trustees were appointed (f. 3), one of whom died. The surviving Trustees are George, the former equity receiver, and Thomas Fitzgerald, former general manager of debtor and a former director of Philadelphia (ff. 3, 221, 382).

The Trustees' Amended Revised Plan of Reorganization for Debtor, on which no hearings have been held, recognizes Philadelphia claims on a parity with publicly held claims.

The Pennsylvania Public Utility Commission, performing its statutory function of approving the new capitalization under the Trustees' Amended Revised Reorganization Plan, said that it is for the federal court to determine the extent to which Philadelphia should participate in the benefits of that plan (23 Pa. P. U. C. 65, 69).

Efforts of Philadelphia to Broaden the Investigation

On December 22, 1944, we, Jules Guggenheim et al., public security holders of Pittsburgh Railways System, filed a sworn petition, in the District Court, setting out spoliation and waste of the debtor by Philadelphia to the detriment of the public security holders, possible causes of action to the debtor's estate and grounds for the equitable limitation or subordination of Philadelphia's filed claim to the claims of public security holders. That petition prayed *inter alia* that the claims of Philadelphia be barred or subordinated. In the consideration of that petition the District Court directed the Special Master at the earliest moment to file his report on the petition of the City of Pittsburgh filed October 23, 1942. Pursuant to

The Facts.

Rule 15, FRCP the prayers for relief in our petition were subsequently amended to a request, among other matters, for an investigation under Sections 21 (a) and 167 of the Bankruptcy Act into possible claims or causes of action available to the debtor against Philadelphia and any other party and into grounds for the subordination or equitable limitation of claims filed by Philadelphia. At the hearing on the amended petition the Securities and Exchange Commission, the City of Pittsburgh and others supported this prayer. Philadelphia did not file or serve any answer denying the allegations of our petition. Philadelphia, purporting to appear specially, moved to dismiss the petition, its contentions including the request that if an investigation be ordered as to it, "a similar investigation should be made with respect to the claims of all creditors". On November 7, 1945 the District Court refused Philadelphia's motion to dismiss, did not adopt its suggestion of an investigation of all creditors' claims, and directed the Trustee to conduct the investigation sought. No appeal has been taken from this ruling.

Philadelphia, again purporting to appear specially, on November 21, 1945, filed a motion to amend the November 7, 1945 order, seeking again to have the inquiry relate not only to Philadelphia but to all holders of the securities and liabilities of the debtor, including public holders, whether or not they filed claims on their holdings. Philadelphia urged that members of the public had bought large amounts of the debtor's securities during the reorganization at low prices; that these purchases were made when the question of Philadelphia's subordination by reason of its previous conduct respecting the debtor had been raised; that the market prices of the securities had gone up substantially since the inception of the proceedings; that any further enhancement by reason of Philadelphia's subordi-

nation might result in the "unjust enrichment" of such purchasers; that these facts, if established, warranted the court in denying public holders the benefits, in whole or in part, of any subordination or limitation of Philadelphia's claims, or in subordinating the claims of these security holders; and that the court should therefore order an inquiry into the identity of the public holders and the time and cost of their purchases. On January 21, 1946, the District Court denied Philadelphia's application with leave to renew "upon a presentation of proper facts in support thereof" (Circuit Court Appeal No. 9125).

On March 6, 1946, Philadelphia, once more purporting to appear specially, filed a petition, which, after reciting the identical substantive facts and conclusions that it had previously presented to the court in support of its rejected motion, prayed for the identical relief. Various parties objected, on practical grounds, on jurisdictional grounds, and on the ground that the facts alleged did not warrant the requested relief. On April 25, 1946, the court, after hearing these objections, determined that it would not receive evidence offered by Philadelphia in support of the allegations of its petitions, and on May 1, 1946, it dismissed the Philadelphia petition without prejudice (Circuit Court Appeal No. 9163).

Observations on Philadelphia's Statement of the Case

At page 3 Philadelphia stresses similarity of some of the allegations in our petition and the city's petition. Both challenge the separate corporate form. The Special Master's report, dismissed the city's petition and upheld the separate corporate form. The Circuit Court reversed and pierced the corporate veil, stating: "the facts * * * call for the treatment of this great transportation system as one entity for reorganization purposes" (155 Fed. (2) 477 at 485).

The Argument.

At page 7 Philadelphia concedes it lacks evidence of any fraud or counterequities against public security holders. Nevertheless, Philadelphia speaks of fraud of public security holders and of counterequities against them in Philadelphia's favor, and does not allege any facts upon which such contentions might conceivably be predicated. These claims are used to color Philadelphia's argument.

Furthermore, Philadelphia is silent on its domination, control and operation of Pittsburg Railways System, alleged in our petition, which, under well-established law, infects Philadelphia, as operating parent, with the claims of the public security holders.

THE ARGUMENT

I

The law is well settled that:

Neither the cost of his security, nor the time of its acquisition, nor his knowledge of the undenied facts alleged in our petition, precludes a public security holder from benefiting through the absolute bar or the complete subordination of the claims of Philadelphia—which operated and controlled Pittsburgh Railway System—to the claims of all public security holders.

No public security holder to whom the sanctions of Section 212 of the Bankruptcy Act are inapplicable, profit by recovery of the entire amount of his security according to its terms.

In re Lorraine Castle Apartments Bldg. Co. (C. C. A. 7), 149 Fed. (2) 55, cert. denied 326 U. S. 728.

Mokava Corporation v. *Dolan* (C. C. A. 2), 147 Fed. (2) 340.

Standard Gas & Electric v. *Deep Rock Oil* (C. C. A. 10), 117 Fed. (2) 615 at 619.

Security-First Nat. Bank v. *Rindge Land and Nav. Co.* (C. C. A. 9), 85 Fed. (2) 557, cert. denied 299 U. S. 613, 86 Fed. (2) 3.

In re Utilities Power & Light Corp. (N. D. Ill.), 29 F. Supp. 763, 770.

In re Indiana Central Telephone Co. (D. Del.), 24 F. Supp. 342, 344.

In re Point Building Land Co. (W. D. Pa.), 37 A. B. R. (N. S.) 464, 466.

In re Celotex Co. (D. Del.), 12 F. Supp. 1, 5.

Philadelphia's authorities were carefully considered below. They are not to the contrary (pp. 11, 12, 15-21, infra).

10 Cir. Dealing with the subordination of a parent's claim, *Standard Gas & Electric* v. *Deep Rock Oil,* 117 Fed. (2) 615, cert. denied 313 U. S. 564, 61 S. Ct. 842, held at page 619 that "the prices which security holders pay for their securities does not affect the measure of their participation under the plan of reorganization."

3 Cir. The Circuit Court at bar said (159 Fed. (2) 630, 633; Rec. p. 90):

> "Appellant (Philadelphia) suggests that it is inequitable to allow them (the public security holders) preferred standing. * * * The preferred status complained of * * * springs directly from the alleged unconscionable conduct of Philadelphia Company (which if established would subordinate or limit the latter's claims) and from the further fact that the appellant's charges contain nothing to prevent the unknown public bondholders from taking advantage of the situation brought about by Philadelphia Company's own acts."

The Argument.

7 CIR. *In re Lorraine Castle Apts. Bldg. Corp.*, 7 Cir., 149 Fed. (2) 55, denied a petition to limit to cost speculating public security holders' claims acquired during the course of the reorganization. That reorganization, like the one at bar, involved a solvent parent, which had guaranteed the obligation of the debtor subsidiary. That court stated (p. 57) that the master "pointed out specifically that the persons who had dealt in the bonds were not officials, directors or stockholders of the corporation; that they owed no fiduciary duty to the estate or its beneficiaries; that they were strangers to the proceedings, investors or speculators in securities who thought the bonds were selling too cheaply and that they might make a legitimate profit upon them. He found that there was no fraud."

2 CIR. *Mokava Corp.* v. *Dolan*, 147 Fed. (2d) 340, 344, 345, from which the court below quoted as follows, held:

> "To reduce a creditor's participation in the plan to the amount he paid for his bonds (except in unusual circumstances not present here) would be harmfully to reduce the value of such bonds to those who previously owned them."

9 CIR. *Security-First National Bank* v. *Rindge*, 85 Fed. (2) 557, cert. denied 299 U. S. 613, involving a debtor in reorganization proceedings under Section 77B. A competition developed between two groups to acquire the bonds held by committee, organized prior to the bankruptcy petition. One group finally acquired 98% of the outstanding bonds at 40 cents on the dollar plus expenses incurred by the committee. The plan of reorganization provided for payment of 40 cents on the dollar on the 98% of the bonds acquired by the purchasing group and

for payment of the remaining 2% of the bonds at the face value. The Circuit Court rejected the contention that payment should be limited to the "consideration paid • • • in acquiring the bonds" and directed full payment to the purchasing group, saying (561):

> "The legal value or property right in an obligation is the right to recover from the maker to the entire extent of his promise to pay. The consideration given for a security by the holder thereof is immaterial."

9 Cir. On rehearing that court said (86 Fed. (2) 3):

> "In the absence of any lawful obligation to the debtor, the purchase of the bonds is not converted into a fraudulent conspiracy because one or all the negotiators had a motive, however unethical in character, which would be satisfied by the fact that the lawful profit, if made, would exhaust the proceeds of the sale of the security given by the debtor corporation and leave nothing for it and its stockholders."

Thus we find accord in the 2nd, 3rd, 7th, 9th and 10th Circuits, without this court or any Circuit Court to the contrary.

As the court below so well said (Record p. 89):

> "Under the sound authority of the above cases the alleged discount purchases of Pittsburgh Railways' securities during reorganization and with notice of the wrongdoing of Philadelphia Company are not thereby either subject to subordination themselves or to counter equities barring them from profiting by the subordination of Philadelphia Company. The opinions cited by appellant are not persuasive to any contrary view."

The fact that the holder of the debentures may have purchased them at less than par does not affect his right to priority (*In re Utilities Power & Light*, supra).

The Argument.

Neither *Mississippi* v. *Cromwell* (pp. 13, 38) nor *Jencks* v. *Quidnick* (pp. 13, 27) nor the aborted excerpts therefrom support Philadelphia.

The *Jencks* case arose out of a transfer challenged as fraudulent. This court said (p. 460): "If the transfers * * * by Spragues for the benefit of their creditors are sustained, the purchaser gets nothing." The purchaser was a champetrer. Philadelphia created and maintained a public trading market for the securities of Pittsburgh Railways. If the purchaser of a publicly traded security is to be considered champetrer, then all trading of public securities must cease.

In the *Mississippi* case the plaintiff was proceeding under an execution sale against Muscatine County, Iowa. He was seeking to have transferred to him railroad stock that had been in the name of Muscatine County, and had been deposited by it under an agreement for the sale of the railroad under foreclosure. This court said (p. 644):

> "Now, as the stock * * * by the foreclosure and sale * * * had become completely valueless, if it had not ceased to exist for any purpose except the perception of the sixteen cents * * * the subsequent levy and sale of the stock belonging to Muscatine County was a vain and useless transaction."

This court could have stopped right there in its refusal to direct issuance of such stock. In referring to this case this court, in the *Jencks* case, said (p. 459): "The property and company was gone—its franchises were gone."

Section 212 in Chapter X of the Bankruptcy Act deals with securities acquired in the course of a reorganization. Its purpose is plainly to protect from the possible machinations of those who owe a fiduciary duty. The Bankruptcy

Court's power to limit to cost securities acquired in reorganization is confined to "attorneys, trustees under indentures, securities holders committees" * * * fiduciaries. Philadelphia's petitions and applications do not state any facts making Section 212 applicable to the public holders whose claims Philadelphia would limit to cost.

Thus the test is, do the public holders owe any fiduciary duty? If not, and the public security holders are investors or speculators who thought the securities were selling too cheaply and they might make a legitimate profit on them, the prices which the public holders paid for their securities and the time at which they acquired them in no way affects their participation in the reorganization.

Neither we nor any public holder are fiduciaries or constitute any part of the debtor's management. On the other hand, Philadelphia bore a fiduciary relation to debtor and constituted debtor's management.

"The Conflict of Equities Under the 'Deep Rock' Rule", 43 Columbia Law Review 336, on which Philadelphia relies, says (p. 336):

> "Subordination of a parent corporation's claim against an insolvent subsidiary to the claims of other creditors of the subsidiary is held to be proper in cases where the parent has been guilty of mismanagement of the subsidiary to the detriment of its innocent creditors in a manner so unconscionable as to preclude the parent's seeking the aid in a bankruptcy court. The principle is applied in its simplest form to the situation of the guilty claimant versus innocent creditors of the debtor * * *."

Page 345:

> "Non-Fiduciaries: (1) Mere information. Should the mere fact that the holder of a claim against or interest in a debtor subsidiary has purchased such claim or

> interest subsequent to the institution of bankruptcy proceedings prevent him from receiving the benefits of subordination in the absence of fraud or even speculation? In the interest of equitable bankruptcy administration the answer should be in the affirmative. The courts, however, have held that there is no equity against such a claimant."

Page 347:

> "Not only have the Courts generally held that mere possession of claims or interests acquired subsequent to bankruptcy proceedings is not an equity against the holder, but they have also held that such a holder is entitled to equal treatment with other claimants where it is shown that he possessed confidential information obtained from the trustee in bankruptcy."

If public holders were limited to the amount paid or treated as Philadelphia contends, neither Philadelphia, as parent, nor the debtor would ever offer to the public anything above the current price for the bonds. This would encourage Philadelphia and the debtor to delay the plan of rehabilitation in the hope that it would be able to settle claims against debtor at less than a fair amount. Such results are not in accord with the purposes of the legislation.

There is no general principle of equity that disentitles public holders to buy bonds, and succeed to all rights of the vendors (*Guaranty Trust Co. of N. Y.* v. *Seaboard Air Line,* 62 F. Supp. 207 at 216).

Philadelphia argues (p. 21), "that one who buys—with his eyes open" has no "standing before a court of equity" under such circumstances. Philadelphia's argument means this: A corporation could plunder a subsidiary, and become insulated from liability by subsequently broadcasting its conduct. How absurd.

The Argument.

If the public's purchases were limited, the price paid would become the maximum obtained in distribution. It might well be less. Faced with such an unremunerative prospect, the public would not purchase reorganization securities, although Congress intended an active market of reorganization securities (see Bankruptcy Act, Sec. 212). Those directly injured would be the public investors who acquired their holdings when the enterprise was solvent. With the disappearance of purchasers upon the commencement of the reorganization, or more probably on the first faint rumors of its imminence, they would remain with no alternative but to hold on to an unmarketable security of declining value.

To say that strangers to the debtor—public holders—should recover less because, the parent, or, a fiduciary who wronged the debtor, recovers less, would be a strange perversion of equity.

Complementary to this contention is the "windfall" argument—that the public holders should not recover more because the parent or a wrongdoing fiduciary recovers less. It is at least possible that the discount prices at which many of these holders bought were in part due directly to the low estate into which the debtor had fallen through Philadelphia's conduct and to the fact that no corrective action had been begun. It appears unseemly, at least, to argue that a low purchase price in which Philadelphia's own conduct may have been a factor should be the basis for denying to the public purchasers the benefits of the corrective action. *Phelan* v. *Middle States Oil Corporation*, 154 Fed. (2) 978 (C. C. A. 2), involved charges of wrongdoing by a fiduciary. In that case, the court summarily disposed of the "windfall" argument as follows (at 1001):

> "It is suggested that a purchaser (such as Cohen) should have no right against a receiver because other-

wise the purchaser will acquire a windfall, since he, like the seller, knew nothing of that right when he purchased. But in a great variety of instances, purchasers are permitted to acquire windfalls, e.g., a buyer of land on which oil is discovered after the sale. The Restatement of Contracts, Sec. 171(2) reads: 'Unless otherwise provided in the assignment or by agreement of the assignee with the assignor or with the obligor, an assignee under an effective assignment for value has the same right to any securities for the assigned right that were available to the assignor, though he has not bargained for them, as if the assignor had agreed to transfer them.' If Glass (the receiver) was guilty of wrongdoing, that Cohen's estate will unexpectedly benefit can work no harm to Glass."

Philadelphia's Cases

In *Godfrey* v. *Powell* (pp. 12, 13) the "appeals * * * deal with one of the concluding phases of that (Seaboard Airline Railway) reorganization in that the plan provides for the inclusion of the properties of the All Florida Lines in its reorganized Seaboard system through purchase by the Reorganization Committee at foreclosure sale at not less than a fair upset price" (487). "Of these (decrees on appeal) one upheld the right of the receivers to hold and use and enforce on the same basis as any other holder the $24,543,000 of bonds they had bought on the authority of court orders as a part, and in aid of the reorganization plan" (487, 488). Appellants bought their securities "after the * * * date when the receivers' offer to purchase bonds expires". The court said that the receivers' bonds "were bought with funds of security holders of Seaboard under orders directly authorizing the purchase and with results contemplated and provided for in the orders" (489). After so determining the merits of the controversy in favor of

parity participation by the receivers, that court in the paragraph following made a statement, only a part of which is quoted by Philadelphia at page 12. Omitted is the sentence immediately following, to wit (p. 490):

> "So considering it (the matter from the standpoint alone of other bondholders) we think no reason is presented or appears why any of the purchased bonds (purchased by the Receivers under court order) should be subordinated to the others or other participation in the proceeds of the sale at all limited." (Matter in parentheses inserted.)

Guaranty Trust Co. v. *Chicago, M. & St. P.*, 15 Fed. (2) 434 (p. 28), denied an application for discretionary intervention in a corporate mortgage foreclosure reorganization made after the decree of foreclosure and sale had been entered (437). Five months elapsed between the entry of the decree and the application for intervention (437, 441).

In re Missouri Pacific R. Co., 64 F. Supp. 64, Philadelphia (pp. 12, 23), omits the crux of that court's conclusion, stated thus at page 77:

> "* * * the Court is impressed by the fact that almost all of the transactions of which Comstock complains were entered into only after notice to, and with the approval of, the Interstate Commerce Commission. No substantiation appears for Comstock's innuendo that the Commission was somehow derelict in its duty, or allowed itself to be hoodwinked."

The quotation in Philadelphia's brief when read with the foregoing which precedes it, means that since the challenged transactions were entered into only after notice to and with approval of the Interstate Commerce Commission, "Comstock cannot contend he is in the position of a person

from whom the facts were concealed" (p. 78 of 64 F. Supp.) for the Interstate Commerce Commission records are public. No such situation is presented at bar. At bar, the Pennsylvania Public Utility Commission referred to the federal court, to determine the extent to which Philadelphia should participate in the benefits of the plan. That is presented to the Federal Court by our petition.

That *Belden* v. *Burke,* 147 N. Y. 542 (p. 23), does not aid Philadelphia is emphasized by the change of conclusion of that case reported at 148 N. Y. 760, concerning which change Philadelphia is silent. That litigation involved and rested on the construction of an indenture creating and securing a bond issue not in default. What did the parties intend, and how had they construed the indenture at the time of its creation, with respect to certain transactions that had taken place? These transactions were challenged in the suit. These had been called to the attention of the underwriters before the bond issue was floated and the court found that at that time the parties construed the indenture as authorizing and approving them. Subsequently, in answer to the plaintiff's specific inquiry, the defendant advised plaintiff that the challenged transactions were valid and proper under the indenture and had been so treated. Plaintiff who thereafter purchased his bonds with actual knowledge of the construction could not retreat from the agreed construction of the matter involved. But that is far different from the situation at bar.

American Brake Shoe v. *Interborough Rapid Transit,* 112 Fed. (2) 669 (p. 24), involved a corporate mortgage foreclosure reorganization going on since 1932. Denying discretionary intervention, that court said, that petitioner had "taken an active part in court hearings" and was

"familiar with the situation for years. His application to intervene in September, 1939, can scarcely be deemed timely. * * * Instead of acting promptly, he postponed intervention until a plan of settlement * * * had been drawn upon the assumption that no party to the proceeding was attacking the validity of the pledged bonds". The petitioner was not allowed to retreat. That cannot be compared to the situation at bar.

In *Continental Trust Co.* v. *Toledo,* 82 Fed. 642 (p. 24), Judge Taft upheld the challenger's right to be heard on the validity of a bond issue "after this long delay, after what looks much like laches" (p. 647 of 82 Fed.). "We come now to the alleged irregularity, illegality and fraud set up in these petitions" (p. 653 of 82 Fed.). Two separate mortgages on the Toledo & St. Louis divisions of the Toledo, Cincinnati & St. Louis Railroad Co., a consolidated corporation, were foreclosed in 1885. That corporation, called the old company, must not be confused with the new company, which is the defendant Toledo, St. Louis & Kansas City Railroad Company. The road of the old company was bought by S. H. Kneeland for the first mortgage bondholders of the foreclosed mortgage, subject to a lien indebtedness. Kneeland formed the new company which issued new securities. Owners of new securities issued by the new company challenged the reorganization of the old company affected by Kneeland. The petitioners, owners of new bonds, contended that "the mortgage bonds are void because the contract of January 23, 1886, made between the old bondholders on behalf of the company to be formed, and Kneeland, the contractor was conceived in fraud" (p. 655).

> "It is said that these (new) bonds were issued in pursuance of a corrupt and fraudulent agreement, and that they are, therefore, not valid obligations of the

company. At the time the contract of January 23, 1886, was made, the petitioners had no relation whatever to the company or its incorporators. The debts of petitioners were none of them contracted until 1892 and 1893. The real parties to the contract of January, 1886, were bondholders under the old mortgages. * * *

Disputes arose between Kneeland and the Company which resulted in agreements of settlement before the debts of petitioners were contracted. Now, it may be that these settlements can be set aside by the Company for fraud."

Then follows matter which Philadelphia quotes on page 19. Thus it is clear that the excerpt in Philadelphia's brief is misleading. Judge Taft simply indicated that the owners of securities in the new company could not challenge transactions affecting the old company. But no such situation is here presented.

Graham v. *Railroad,* 102 U. S. 148 (p. 24). The railroad, while solvent, and with no actual intent to defraud creditors, made a voluntary sale of certain lands for an inadequate consideration. Three years later, appellants recovered two judgments against the company on contract indebtedness arising after the sale of the lands.

"The main question is, whether the sale to Nash, made before the Railroad Company became indebted to the appellants, and when for all that appears it was perfectly solvent, * * * can be set aside as the instance of the complainants, for the purpose of subjecting the lands to sale under their execution. And this question we think, must be answered in the negative.

It is a well settled rule of law, that if an individual, being solvent at the time, without any actual intent to defraud creditors, dispose of property, for an inadequate consideration, or even make a voluntary con-

veyance of it, subsequent creditors cannot question the transaction. They are not injured. They gave credit to the debtor in the status which he had after the voluntary conveyance was made" (p. 153 of 102 U. S.).

Palmer v. *Bankers Trust Co.*, 12 Fed. (2) 747 (p. 28), refused to allow a participant to retreat from his position. That case denied a petition for discretionary intervention filed August 2, 1924 (750), after a plan or reorganization had been under discussion for several years" (750) and the plan "approved by three committees of bondholders" had been approved (750). That reorganization was effected in a foreclosure proceeding where it is common to fix an upset price. There the upset "price was fixed by the court, after full opportunity for everyone interested to be heard. Petitioner was invited to participate in the hearing. * * * In view of all the evidence * * * we cannot say that the upset price fixed by the court was too low, nor that the acquiescence therein by the trustee showed bad faith or bad judgment" (754). The right to participate and to be heard in the reorganization proceedings of the debtor at bar is not discretionary but absolute under the Bankruptcy Act.

DeWeese v. *Reinhard*, 165 U. S. 386 (p. 388), involved title to real estate. Mr. Justice Brewer said (p. 388): "All the facts upon which his contention rests are matters of statute and record and any apparent legal title created by them was available in the action to recover possession" (p. 392). "The County records also notified him of the several conveyances and the amount of money paid by the appellees. He was, therefore, simply an intruder." The Supreme Court rejected the contention that the government was a trustee of the lands in question to see that they

should be applied as directed by Congress, his claim being they had been misapplied.

Philadelphia seeks to invoke by analogy the principle of stockholder's derivative or secondary suits. Rule 23(b), FRCP, is a rule of procedure and not of substantive law (*Galdi* v. *Jones,* 2 Cir., 141 Fed. (2) 984; *Goldstein* v. *Groesbeck,* 2 Cir., 142 Fed. (2) 422). The shareholder is only an instigator in the derivative suit. But a suit by either a stockholder or a creditor (bondholder) for the enforcement of his individual right for a recovery to the stockholder or creditor individually for himself and those similarly situated is not governed by the principle of Rule 23(b), FRCP, for it is not a stockholder's derivative suit (*Cohen* v. *Cities Service,* 2 Cir., 45 Fed. (2) 687; *Davidson* v. *Bankers B & M,* 35 F. Supp. 825). In a secondary or derivative suit, recovery runs to the corporation or fiduciary and the benefits of that recovery inure to every stockholder, even one who acquired his stock subsequent to the challenged transaction, and even though he was disqualified to instigate the litigation. Elimination or subordination of Philadelphia will directly affect the public holder such as we are, and not the debtor. The principle of Rule 23(b), FRCP, has no application at bar.

Significantly, Philadelphia's discussion of the Deep Rock rule (pp. 2, 9, 31) says nothing of the well established rule, where, the debts of a subsidiary are to be treated as the debts of the parent.

The Master's fact findings support the allegations in our petition, that, so far as the charter set up is concerned, Philadelphia and Pittsburgh Railways system are a number of separate entities, while in truth and in fact, each of the entities in Pittsburgh Railways system was but a department, agency and instrumentality of Philadelphia. The District Court said:

64 Fed. Supp. 232:

> "In the consideration given to the petition of Jules Guggenheim et al., the Court considered, inter alia, the facts averred in the petition * * *."

Record, page 80-a:

> "There were special reasons for the investigation of the claims of Philadelphia Company. It is the sole stockholder of the Pittsburgh Railways Company, it is the largest creditor and it controls a large majority of the underlying companies."

All public security holders are entitled to full payment of their claims and priority over Philadelphia's claims. Philadelphia's contentions are like Germany's demands for reparations.

II

There is no warrant in the Bankruptcy Act for an examination under Section 21(a) or an investigation under Section 167 of all public holders of notes, bonds, securities or liabilities of the debtor to ascertain when and at what prices these public holders acquired their securities.

In re Prudence Co., Inc. (C. C. A. 2), 88 Fed. (2) 628, 629;

Security-First Nat. Bank v. *Rindge* (C. C. A. 9), 85 Fed. (2) 557, 562; 86 Fed. (2) 3;

In re Fox Metropolitan Playhouse (C. C. A. 2), 74 Fed. (2) 722;

In re Youroveta Home & Foreign Trade Co., Inc. (C. C. A. 2), 288 Fed. 507;

In re Madero Bros., 256 Fed. 859;

The Argument.

In re Horgan (C. C. A. 2), 98 Fed. 414;
In re Chanson (D. C. N. Y.), 20 Fed. Supp. 244;
2 *Collier on Bankruptcy,* 14 ed., p. 281, Sec. 21.11;
Black on Bankruptcy, Sec. 269.

The question is: does the Bankruptcy Act authorize an examination and an investigation of public security holders to ascertain either the consideration paid for their securities, or the time of acquisition, or the knowledge of facts requiring the parent's subordination? The answer is no.

The course which Philadelphia would pursue is not only without statutory justification but in complete disregard of the Bankruptcy Act (compare *In re Steinman,* 3 Cir., 155 Fed. (2) 755 at 759).

Since Philadelphia's applications rest on Section 21(a) and Section 167 of the Bankruptcy Act, its applications must fall, unless authorized by the statute. Hence the judicial eye must ascertain whether or not the proposed inquiry is relevant or material to matters within the scope of Sections 21(a) and 167. It is not.

While Section 21(a) is limited to the "acts, conduct and property of the bankrupt", Section 167 extends to the "acts, conduct, property, liabilities and financial condition of the debtor and the operation of its business" (sub. 1), to "directors and officers of debtor" (sub. 2), to "fraud, misconduct, mismanagement and irregularities and to causes of action available to the estate" (sub. 3). In clear and unmistakable language Section 167 provides for an investigation of corporate management-fiduciaries.

Nothing in Philadelphia's moving papers either directly or indirectly charges or suggests that the public security holders proposed to be examined or investigated, were directors or officers or formed any part of the management

of debtor or of underliers or are charged with fraud, misconduct or mismanagement against the debtor or against any underlier or that any cause of action is available to the estate against any such public security holder.

Philadelphia has not denied the allegations of our petition which states, inter alia,

> "Philadelphia Company officered and financed the debtor and underliers."

Denying a Section 21(a) examination, Circuit Judge Learned Hand, then a District Judge, in *In re Madero Bros.*, 256 Fed. 859, at page 860, said:

> "The question rather is whether the examination concerns 'the acts, conduct and property of the bankrupt'; for, if it does not, then it is not authorized."

The cost to public holders of their securities, and the time when same was acquired, or their knowledge of Philadelphia's conduct of debtor, are not even remotely suggested as a subject of inquiry under these sections.

What the public holders paid for their claims, and, when, where and why they purchased, do not concern the acts of the debtor, the conduct of the debtor, or the property of the debtor, or the debtor's liabilities. The word "liabilities" has reference to liabilities of the debtor (*In re Security First National Bank* v. *Rindge,* 9 Cir., 85 Fed. (2) 557). These are private affairs of non-fiduciaries not subject to inquiry (2 Collier on Bankruptcy, 14 ed., p. 281, Sec. 21.11). In reality what is sought is an inquiry into the conduct and private business of public security holders and not the affairs of debtor. This cannot be done (*In re Prudence Co.,* 2 Cir., 88 Fed. (2) 628, 629). Philadelphia's proposed investigation is clearly not "to protect creditors, particularly from possible machinations of those who owe a

fiduciary duty. There is no fiduciary obligation between a creditor and a debtor" (*Security-First Nat. Bank* v. *Rindge,* 9 Cir., 85 Fed. (2) 557, 562).

In re Fox Metropolitan Playhouse, Inc., 2 Cir., 74 Fed. (2) 722, denied an application by creditor for a Section 21(a) examination of the members of the two banking firms who had dealt in the corporation securities. The court said:

> "As the petition is drawn, it is apparent that the petitioner desired to make inquiry not into the 'acts, conduct or property of a bankrupt whose estate is in the process of administration,' but rather into * * * the manipulations or conduct of the members of the noteholders' protective committee."

"In general, a large latitude of inquiry should be allowed in the examination of persons closely connected with the bankrupt in business dealings or otherwise, for the purpose of discovering assets and unearthing frauds, upon any reasonable surmise that they have assets of the debtor" (*In re Foerst* (D. C. N. Y.), 93 Fed. 190, 191). The record is clear that Philadelphia alone falls in that category.

Section 21(a) requires the order be for a "designated person". How would Philadelphia reach public security holders who have not disclosed their identity by failing to file a claim? How can their examination be ordered in the face of Section 21(a)? The securities of debtor and of underliers are and have been publicly traded in for many years. Thus the statutory requirement for a designation precludes the John Doe "fishing excursions" sought by Philadelphia.

The Bankruptcy Act at Section 41(a) (11 U. S. C. A. 61) provides that no person shall be required to attend a place

outside the State of his residence, and more than 100 miles from such place of residence. The security holders are so widely scattered that some may reside in every state of the United States and in foreign countries. Some of our Federal courts have more than one district, others have divisions as well. The great state of Texas spans 1,000 miles. Is this long drawn out reorganization to be turned into a countrywide—yes, worldwide— goose chase, with a separate inquiry in every hamlet?

Though the order of November 7, 1945, directed the trustee to conduct an examination under Section 21(a) of the Bankruptcy Act, and though Section 21(a) of the Bankruptcy Act contemplates oral testimony under oath, the Trustee has not examined Philadelphia or any witness.

If the Court were to grant the relief sought by Philadelphia, the public holders may dump their securities on the market, rather than he subjected to examination and investigation. That would break the market and would enable Philadelphia to pick up the public securities at a fraction of their face amount. What a bonanza that would be for Philadelphia. The court's protective umbrella would close and become a stiletto to stab the public security holders.

The purpose of the Bankruptcy Act is to protect creditors (*Security-First Nat. Bank* v. *Rindge Land & Navigation Co.*, 9 Cir., 85 Fed. (2) 557).

III

That there is no conflict of decision on the point in issue is clear from Point I.

IV

The questions presented by Philadelphia are not of sufficient importance to require review by this Court.

Philadelphia's crocodile tears, at bar, like those of its parent in *Standard Gas & Electric* v. *Deep Rock,* 10 Cir., 117 Fed. (2) 615, 619, may well be compared to those of the Queen in her efforts to destroy Snow White.

CONCLUSION

It is respectfully submitted that Philadelphia's petition for certiorari should be denied.

Respectfully submitted,

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